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MONTHLY PROJECTIONS
June 1987

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INFLATION SCARE SHOULD EASE THROUGH SUMMER

After surging by 0.7% in April, the PPI has settled to only a 0.3% increase in May, and virtually all of that was the result of meat price increases. Consumer prices, which had increased at a 6% annual rate for the first four months slowed to a 4% rate in May, again with a disproportionate share of the increase caused by rising meat prices. Even a surge in commodity prices has begun to ease. The Journal of Commerce Index of Industrial prices peaked at 99.5 in mid-June and now has been trending down slightly since that time. Precious metal prices are 10% below their spring peaks while the dollar has rebounded modestly against the industrialized currencies.

Some of the slowing of inflation was expected, although the speed by which inflation has diminished is slightly surprising. Energy prices rebounded from less than $14 per barrel late in 1986 to more than $18 per barrel at the Persian Gulf at the present time. OPEC is apparently able to abide by production quotas sufficiently to insure that the $18 per barrel will be preserved until the heating season. Despite problems with controlling production from Iraq, the production goals set for the fourth quarter might even generate a slight increase in oil prices. However, the pricing issue really depends upon how Saudi Arabia responds to shifting market demand conditions. If Saudi Arabia increases and decreases production to insure a constant price, as anticipated, then stable energy prices should prevail into next year. Petroleum product prices still are several cents per gallon behind what would be consistent with $18 oil at the Persian Gulf. As the summer driving season reduces the excess oil product inventory, prices will drift upward. However, the large increase in energy-related prices already has occurred. For example, we are projecting a 16.2% increase in energy commodity prices from December 1986 to December 1987. If our June projections are correct, we already are more than 15.3% up from the December levels.

Meat prices soared earlier this year because livestock raisers were withholding animals from slaughter in order to rebuild their herds. The farrowing

intentions of hog raisers show that significant amounts of pork product probably will be available in the fall. Already, significant expansion of poultry capacity has led to a topping out of prices in that meat component. While fish prices are continuing to soar because of increased demand, beef prices should gradually diminish as supplies of pork and poultry increase. Once again, virtually all of our projection of meat price increases for the entire year have already occurred during the first six months. While food price inflation will remain significant in June, it probably will not be a significant factor during the summer.

The dollar's weakness was the third significant force generating increasing inflationary pressures early in 1987. The dollar has now rebounded, not because of any significant policy changes at the Venice economic summit, but because the Japanese have established a weekly reporting system to apply moral suasion against currency speculation. Indeed, many Japanese investors believed that the government would continue to restrain currency speculation until a 150 yen-dollar relationship was achieved. However, the weekly reporting rule has been suspended with the yen only slightly above 145, suggesting that the yen's target range is somewhat lower than had been expected. However, the Japanese did not sterilize their intervention in the currency markets, causing a significant acceleration in the growth of Japanese monetary aggregates. At the same time, the United States has gradually tightened its monetary policy. This has led to a slightly reduced excess supply of dollars relative to yen which should prevent any serious weakness in the dollar through the summer months.

Unfortunately, several members of the Federal Reserve board, especially Martha Seger and Robert Heller, continue to maintain that the Federal Reserve should currently be more concerned about sluggish growth than about inflationary flare-ups, such as the one that occurred in May. The Federal Reserve probably is following an interest rate rule during this interim period when Paul Volcker is job hunting and Alan Greenspan is not yet confirmed by the Senate. However, these board members almost certainly will try to encourage increased monetary expansion and reduced interest rates as soon as the interregnum is over. Such a policy will lead to another bout of dollar weakness in the fall and another flare-up of inflationary pressures, especially if the OPEC quotas lead to increased energy prices during the heating season. However, with inflation again diminishing during the summer, pursuit of an interest rate rule will lead to relatively modest monetary growth, thereby preserving prevailing exchange rates between the dollar and other industrialized currencies.

Also, automobile inventories still remain excessive relative to anemic sales. The industry has slowly begun abandoning incentives, which should keep sales relatively sluggish until the year-end sales programs. This will result in reduced production in order to control auto inventories. Such production declines will slow economic expansion, leading to less than 2% GNP growth according to our projections in the next two quarters. A resurgence of inflation late in the year, however, should reaccelerate industrial prices and lead to speculative increases in inventory holdings. The result will be signficant gains in economic activity but that activity will be highly unbalanced. Whether the Federal Reserve responds quickly enough to dump down the new inflation risk that is anticipated at that time will determine whether growth has become sufficiently unbalanced to threaten a recession before the end of 1988.

A summer with reduced inflationary pressures should lead to slightly more favorable financial markets. Although Japanese investors were unwilling to

purchase significant amounts of the seven-year bond offered in the mini-funding, this occurred because of shifts in Japanese policy toward currency speculation. Investors in that country rightly assumed that the yen-dollar relationship would no longer improve. Even a 5 percentage point interest rate differential apparently was not enough to overcome the currency loss fears of the Japanese investor. By the time of the quarterly funding in early August, a slightly lower dollar against the yen may reduce those currency concerns. At any rate, the expansionist members of the Federal Reserve Board are expected to encourage a reduction in interest rates soon after Greenspan becomes chairman. This should result in relatively favorable conditions in the financial markets until the fall.

Quarterly Profile of GNP

	1987-1	1987-2	1987-3	1987-4	1988-1	1988-2	1987 Annual	1988 Annual
Real:	4.8	1.5	2.0	2.3	3.5	2.0	2.4	2.3
Price:	4.2	4.8	4.4	4.6	4.3	4.4	3.5	4.4
Nominal:	9.1	6.4	6.5	6.9	7.9	6.6	6.0	6.8

Monthly Statistical Highlights for June 1987

Payroll employment +194,000; index of hours worked +0.2%; household employment +47,000; civilian unemployment rate 6.4%; personal income +0.6%; savings rate 3.3%; personal consumption +0.5%; retail sales +0.6%; auto sales 9.9 million units; housing starts -1.8%; housing permits +0.4%; construction expenditures -0.3%; business inventories +0.3%; orders for durable goods -2.7%; orders for nondefense capital goods +0.8%; industrial production +0.2%; CPI +0.3%; PPI +0.2%; consumption deflator +0.3%; leading indicators +0.3%; real GNP +1.0%; M1 -5.3%; M2 +2.8%.

Monthly Statistical Highlights for July 1987

Payroll employment +175,000; index of hours worked +0.2%; household employment +227,000; civilian unemployment rate 6.4%; personal income +0.5%; savings rate 3.3%; personal consumption +0.6%; retail sales +0.6%; auto sales 9.9 million units; housing starts -1.3%; housing permits -1.4%; construction expenditures -0.4%; business inventories +0.3%; orders for durable goods -1.4%; orders for nondefense capital goods -2.1%; industrial production +0.2%; CPI +0.3%; PPI +0.3%; consumption deflator +0.3%; leading indicators +0.2%; real GNP +1.3%; M1 +6.4%; M2 +6.4%.

Commentary

Employment - The June employment survey is unusually early in the month and probably will result in a lower estimate of civilian employment gains than would have occurred with a differently timed survey. In addition, the reduced number

of weeks between surveys should restrain the growth of payroll employment. The latest benchmark revisions substantially reduced the growth of payroll employment during the first part of the year. The sharp drop in hours worked originally estimated between February and March was eliminated. The revisions also led to a slower rate of increase in the hourly earnings index than had previously been anticipated. The actual surge in manufacturing wages was eliminated upon revision. Thus, fears of renewed wage inflation are not justified at the present time. On the other hand, some acceleration in wage pressures should be generated from the increased inflationary pressures that developed early in the year.

Personal Income and Outlays - Farm income fell to a surprisingly low $11 billion in May as no crop support programs were available. As the winter wheat harvest progresses, however, subsidies should rise. Moreover, the spring increase in short-term interest rates is beginning to be reflected in property incomes. Therefore, the relatively modest rates of growth in personal income in the last two months will give way to stronger growth in the summer.

As expected, tax collections returned to more normal levels following capital gains payments in April. However, the savings rate is unusually low, but consumers are unlikely to increase their savings until asset values end their upward movement. This explains why our projections of savings show little change until the first of next year and then gradually intensify. Of course, tax liabilities also distort the savings pattern over the year, as changes in indexation are calculated in the early months of the year. This normally leads to lower estimates of tax liabilities early in the year followed by rising tax liabilities later on.

There has been virtually no increase in transfers and interest payments by consumers since the first of the year. However, the increase in interest rates during the spring probably should increase the interest component.

Weakness in sales both for automobiles and furniture caused a significant decline in durable goods outlays in May. A slight rebound in automobile sales and an anticipated rebound in furniture sales should cause stronger outlays for consumption in June. Nondurables also were surprisingly modest despite reasonably strong gains for nondurable retail activity. This suggests that the energy components, especially fuel oil, were unusually low. Such reductions in spending patterns should not persist, leading to a significant rebound in nondurables during June. A modest rebound also is expected in service expenditures, although financial commissions are expected to remain sluggish. Although real consumption expenditures in May apparently fell significantly, consumer spending in the second quarter still will exceed first quarter averages because of the surprisingly dramatic reduction in durable consumption spending during January.

Construction - Housing permits in May fell more sharply than anticipated although starts were close to expectations. Most of the weakness in permits was in single-family activity, suggesting further weakness in single-family starts in the months ahead. Multi-family activity appears to be developing a range of activity between 450,000 and 480,000 units. This relatively modest rate of multi-family activity is expected to persist through the remainder of this year. The weakness in single-family starts probably reflects financing fears about housing as a result of the sharp increase in mortgage rates during late April and early May. Mortgage rates are expected to drift downward during the summer, but the damage probably is done for single-family starts at the present time.

Construction expenditures were revised upward early this year as public construction and residential construction both were stronger than originally recorded. Public construction should continue to rebound significantly as a result of increased highway financing. Also, many state and local governments have captured the tax windfall associated with federal tax changes. Nonresidential construction has continued to perform stronger than anticipated, but the latest F. W. Dodge report for May shows that construction contracts for nonresidential activity fell 8%. Construction should continue to be a drag upon economic activity into the early months of 1988 when, barring any significant increase in mortgage rates, the construction correction should gradually bottom out.

Business Activity - Although inventory accumulation probably will be less during the second quarter than in the first quarter, factories now are accumulating inventories. In addition, production of automobiles suggests that auto inventories will rise slightly further, although not at the rate they increased in the first quarter. Auto inventory liquidations then are expected during the summer months.

The surprisingly strong report for durable goods was the result of a smaller decline in defense shipments than had been expected and a significant gain in commercial aircraft orders. These commercial aircraft orders probably will not be available in June. In addition, further declines in defense orders could be anticipated. The strong gains in nondefense capital goods orders have not been reflected in increased capital shipments. Although capital spending will be up during the second quarter because of surprising weakness early in the year, the rate of increase is relatively modest.

On the other hand, industrial production rebounded nicely in May after upward revisions in the previous months. The industrial sector now is performing well in comparison to a year ago. Auto assemblies were only 7.1 million units in May and, still, industrial production was able to increase 0.5%. This suggests that reasonable gains in industrial production should be anticipated through the summer months even as further production curtailment in the auto industry begins to whittle away the excess inventories there.

Prices - As mentioned above, inflationary pressures are receding following a significant spurt in the winter and early spring months. Commodity inflation should moderate significantly during the summer before reaccelerating modestly in the fall. As a result, the CPI probably will grow by less than 4% in the summer months. This also will cause a moderation in the consumption deflator. However, the surge in the deflator during the second quarter may lead to higher estimates for the GNP deflator than originally expected. Inflation rates then will moderate significantly during the summer months.

Miscellaneous - The trade balances were more favorable in April than had been anticipated. This was caused both by a significant increase in exports and surprisingly little expansion in imports as a result of a decline in oil imports. Our current production and consumption levels suggests that we require nearly 210 million barrels of imported oil a month. Yet, in April, imports were only 168 million. Furthermore, import prices are continuing to rise. For that reason, further significant gains in our trade balances will be difficult over the next several months. However, the expansion in exports is encouraging and suggests that greater improvement in our trade balances will be achieved than had been expected in our May forecast.

The leading indicators should continue to perform well during the summer as inflation slows and as the stock market probably continues to generate favorable results. More difficult problems should develop in the fall although building permits may not be showing further weakness at that time. Indeed, the indicator components could rise moderately over the next twelve months as there appears to be no significant bunching of weak components. Some of the sectors showing weakness currently should have their weakness bottoming out even as other sectors begin to correct.

Financial Markets

Although manufacturers are continuing to rebuild their inventories, the reduction in automobile inventories should exert downward pressures upon corporate borrowing during the summer months. Reductions in mortgage financing should increase the amount of funds provided by the household sector, but the government sector probably will experience a rise in deficits following unexpected tax collections from capital gains. Nevertheless, the flow of funds suggest that interest rates could decline modestly during the summer excluding the behavior of foreign investors. If the dollar remains relatively stable as a result of earlier monetary restraint, as expected, foreign investors probably will continue to willingly provide capital. If so, interest rates could move downward slightly.

Of course, I am assuming that the expansion-minded members of the Federal Reserve will eventually succeed in encouraging a lower federal funds target soon after Chairman Greenspan is confirmed. However, this will lead to an acceleration in money growth and begin to undermine the dollar's strength in currency markets. By the fall, the resumed weakness of the dollar might then lead to increased inflationary pressures resulting in a Federal Reserve response. At that time, the Federal Reserve probably would allow an increase in the discount rate and this would lead to higher bank lending rates.

Early in 1988 increased inflationary pressures could lead to increased speculative holdings of inventories. This, in turn, would lead to higher short-term interest rates. Yields on long-term government bonds are expected to reach 9% late this year and continue to provide yield through much of 1988.

Equity Markets - Operating profits are rebounding significantly during the summer months as wage levels continue to remain modest. However, increased interest rate burdens are limiting the degree to which profitability is rising. Interest rates are expected to fall in the summer, which should combine with rising earnings to lead to higher equity values. However, the equity markets really did not sell off on the upward pressures of interest rates in the spring. Thus, equity values probably are currently excessive for projected earnings potential. Nevertheless, a summer increase in equity values is likely because of the moderation of interest rates and the modest strengthening in the value of the dollar. Technology stocks still hold some prospects for increased valuation, as their production levels are rebounding from recessionary activity. However, cyclical stocks probably will only continue to progress until the speculative inventory holdings of industrial materials begins in earnest early in 1988. Interest sensitive issues may also rebound in the summer but should fall when interest rates begin rising in the fall.

It now appears that the equity markets will continue to rise during the summer and could reach as high as 2700 on the Dow. During the fall, however, rising interest rates should reduce prospects of further gains. The stock market still is expected to sell off significantly and struggle to remain above 2000 during its fall and winter slide. A more severe contraction than that is not anticipated at the present time, however.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	101626	100919	119.9	118.7	111011	111011	6.7	6.7	170.7	171.2
February	101862	101150	120.9	119.7	111382	111382	6.7	6.7	171.4	171.8
March	102026	101329	120.4	119.6	111368	111368	6.6	6.6	171.8	172.2
April	102263	101609	120.7	119.6	111643	111835	6.5	6.3	172.2	172.5
May	102479	101732	121.0	120.1	111903	112447	6.5	6.3	172.7	172.6
June	102695	101926*	121.3	120.3*	112178	112480*	6.4	6.4*	173.1	173.0*
July	102837	102101	121.5	120.5	112321	112707	6.4	6.4	173.6	173.4
August	102973	102373	121.5	120.8	112485	113036	6.4	6.3	174.0	173.8
September	103109	102568	121.6	121.0	112286	113392	6.6	6.1	174.4	174.2
October	103295	102840	121.8	121.3	112627	113453	6.6	6.1	174.9	174.7
November	103476	103095	122.1	121.6	112917	113693	6.5	6.0	175.4	175.0
December	103654	103291	122.4	121.8	113208	113895	6.5	6.0	175.8	175.6
January 1988	103789	103493	122.5	122.0	113356	114079	6.6	5.9	176.5	176.4
February	103927	103606	122.6	122.1	113483	114227	6.7	6.0	177.3	177.0
March	104065	103797	122.5	122.3	113442	114429	6.6	6.0	178.2	177.6
April	104228	104008	122.8	122.5	113725	114651	6.5	6.1	178.6	178.2
May	104410	104194	123.2	122.7	113902	114820	6.5	6.1	179.1	178.8
June	104592	104373	123.4	122.9	114091	115016	6.5	6.0	179.6	179.4

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	3.553	3.553	2.129	2.129	118.8	118.8	3.024	3.024	2.905	2.905
February	3.599	3.598	2.145	2.146	103.2	99.4	3.075	3.070	2.972	2.971
March	3.604	3.609	2.153	2.155	105.6	104.7	3.087	3.076	2.981	2.971
April	3.619	3.622	2.163	2.162	100.3	3.1	3.095	2.993	2.995	2.990
May	3.634	3.630	2.172	2.171	97.2	101.8	3.107	3.094	3.010	2.992
June	3.650	3.651*	2.180	2.182*	90.4	104.2*	3.115	3.112*	3.025	3.008*
July	3.665	3.671	2.190	2.192	85.2	103.7	3.126	3.129	3.041	3.025
August	3.679	3.692	2.201	2.205	79.6	100.0	3.137	3.146	3.058	3.046
September	3.695	3.709	2.209	2.215	75.6	99.2	3.148	3.159	3.073	3.060
October	3.717	3.730	2.218	2.229	73.5	105.0	3.162	3.176	3.089	3.071
November	3.733	3.748	2.232	2.239	69.7	102.0	3.176	3.190	3.106	3.088
December	3.750	3.770	2.245	2.252	65.3	98.9	3.190	3.208	3.125	3.109
January 1988	3.756	3.789	2.254	2.268	85.6	117.8	3.226	3.244	3.141	3.126
February	3.779	3.808	2.264	2.279	90.3	123.3	3.243	3.265	3.153	3.142
March	3.805	3.830	2.275	2.291	99.7	122.5	3.268	3.285	3.168	3.163
April	3.824	3.851	2.286	2.304	96.3	129.7	3.285	3.303	3.189	3.173
May	3.844	3.870	2.298	2.317	93.5	127.3	3.297	3.318	3.204	3.191
June	3.863	3.893	2.307	2.331	90.4	128.9	3.310	3.337	3.220	3.208

Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections.

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	2806.6	2803.1	364.8	364.9	946.8	946.4	1495.0	1491.8	2408.9	2405.7
February	2873.7	2872.4	394.3	395.2	970.0	969.4	1509.3	1507.8	2460.0	2458.2
March	2882.6	2873.2	397.2	389.9	971.6	964.5	1513.9	1518.8	2459.3	2450.2
April	2895.8	2891.8	395.1	399.1	976.5	966.0	1524.2	1526.7	2460.3	2455.0
May	2910.0	2893.3	394.2	393.2	980.8	967.2	1535.0	1532.9	2464.0	2445.8*
June	2925.4	2909.1*	396.9	394.2*	985.1	975.1*	1543.4	1539.8*	2467.7	2451.0
July	2941.0	2925.9	399.2	396.3	989.3	981.0	1552.5	1548.6	2471.4	2456.2
August	2958.5	2947.0	402.3	402.7	994.6	986.5	1561.6	1557.8	2475.7	2466.1
September	2972.7	2960.6	405.5	402.1	996.6	991.7	1570.6	1566.8	2480.0	2467.3
October	2988.2	2971.5	407.6	397.0	1000.9	998.7	1579.7	1575.8	2481.9	2466.1
November	3005.1	2988.2	409.1	400.1	1006.5	1002.7	1589.5	1585.4	2487.7	2471.1
December	3023.9	3009.0	410.5	404.4	1013.0	1008.1	1600.4	1596.5	2493.2	2478.2
January 1988	3039.0	3025.8	412.4	407.1	1017.3	1012.8	1609.3	1605.9	2497.1	2483.6
February	3051.3	3041.0	414.4	409.5	1018.8	1017.6	1618.1	1613.9	2497.0	2486.9
March	3064.8	3061.5	416.3	413.1	1021.7	1023.6	1626.8	1624.8	2500.8	2494.0
April	3085.8	3072.0	417.8	411.4	1028.5	1027.1	1639.5	1633.5	2506.7	2492.4
May	3100.5	3089.1	417.1	413.0	1034.0	1032.8	1649.4	1643.3	2508.5	2497.4
June	3115.7	3106.1	417.0	416.6	1039.5	1036.9	1659.2	1652.6	2509.4	2500.4

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.58	118.58	20.04	20.04	8.2	8.2	74.81	74.81	23.73	23.73
February	124.41	124.28	20.76	20.40	9.9	9.9	76.73	76.92	26.93	26.97
March	124.67	124.59	20.65	20.16	10.2	10.2	76.82	76.65	27.20	27.78
April	125.04	124.79	20.80	19.97	10.0	10.4	77.20	76.82	27.04	28.00
May	125.12	124.03	20.75	19.86	9.6	9.7	77.54	77.25	26.83	26 93
June	125.88	124.73*	20.72	19.93*	9.9	9.9*	77.88	77.64*	27.28	27.16*
July	126.64	125.45	20.88	19.96	10.0	9.9	78.22	78.11	27.54	27.38
August	127.38	126.66	21.06	20.07	10.0	10.2	78.63	78.55	27.69	28.04
September	127.65	126.99	21.23	19.91	9.9	10.2	78.79	78.96	27.63	28.12
October	128.47	126.94	21.30	19.83	10.0	9.6	79.13	79.52	28.04	27.59
November	129.16	127.64	21.33	19.99	10.1	9.7	79.58	79.84	28.25	27.81
December	130.02	128.58	21.15	20.08	10.3	9.9	80.09	80.27	28.78	28.23
January 1988	130.63	129.27	21.34	19.95	10.3	10.1	80.43	80.64	28.86	28.68
February	130.92	129.94	21.45	20.13	10.3	10.1	80.55	81.02	28.92	28.79
March	131.08	130.85	21.53	20.21	10.2	10.3	80.78	81.50	28.77	29.14
April	131.97	130.92	21.57	20.16	10.2	10.2	81.31	81.78	29.09	28.98
May	132.41	131.57	21.65	20.29	10.1	10.2	81.75	82.23	29.01	29.05
June	132.85	132.32	21.62	20.46	10.1	10.3	82.18	82.56	29.05	29.30

Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections.

CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	1.816	1.816	1.253	1.253	1.690	1.690	374.8	381.1	339.0	344.6
February	1.833	1.838	1.299	1.303	1.763	1.676	378.4	386.8	341.3	348.9
March	1.774	1.749	1.245	1.226	1.757	1.719	375.2	382.4	337.7	344.3
April	1.767	1.665	1.225	1.222	1.698	1.598	375.9	384.1	337.4	345.6
May	1.718	1.620	1.189	1.129	1.653	1.477	376.2	381.7*	336.8	342.6*
June	1.654	1.591*	1.138	1.115*	1.589	1.483*	375.7	380.7	335.4	340.8
July	1.642	1.570	1.130	1.096	1.564	1.462	375.0	379.3	333.9	338.7
August	1.642	1.595	1.132	1.117	1.541	1.483	373.4	378.7	331.6	336.9
September	1.629	1.618	1.119	1.125	1.527	1.516	372.1	379.2	329.9	336.8
October	1.610	1.576	1.106	1.104	1.506	1.501	371.3	378.4	328.3	335.5
November	1.586	1.590	1.096	1.112	1.485	1.482	371.4	379.0	327.2	335.4
December	1.580	1.575	1.087	1.098	1.488	1.465	371.3	378.3	326.0	333.9
January 1988	1.618	1.545	1.105	1.083	1.531	1.428	372.4	378.3	326.1	333.0
February	1.632	1.553	1.126	1.088	1.553	1.443	373.1	377.6	326.1	332.1
March	1.607	1.570	1.108	1.102	1.528	1.458	374.4	377.9	326.4	331.5
April	1.590	1.576	1.102	1.105	1.507	1.472	376.4	379.7	327.3	332.5
May	1.589	1.598	1.109	1.121	1.493	1.496	378.6	382.2	328.4	333.8
June	1.585	1.578	1.104	1.106	1.495	1.493	380.9	382.7	328.9	333.4

	Non-Residential		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.2	121.8	75.1	73.9	181.5	185.4
February	121.0	126.4	78.0	75.5	179.4	184.9
March	118.1	121.3	75.1	76.4	182.0	184.7
April	117.4	123.7	76.0	76.2	182.5	184.2
May	116.8	122.9*	76.6	76.5*	182.8	182.3*
June	116.1	122.6	77.2	77.3	182.4	180.8
July	116.5	122.4	77.8	77.5	180.7	179.4
August	116.0	121.7	78.2	77.9	179.2	179.1
September	115.7	120.9	78.7	78.4	177.7	179.9
October	115.3	120.3	79.1	78.8	176.9	179.3
November	115.8	120.1	79.6	79.4	176.0	179.5
December	115.9	120.2	78.9	79.8	176.5	178.3
January 1988	115.7	119.6	79.6	80.5	177.1	178.2
February	115.5	119.8	80.1	80.9	177.5	176.9
March	115.8	119.8	80.7	81.4	177.9	176.7
April	116.3	120.4	81.5	81.7	178.6	177.6
May	116.8	120.6	82.3	82.3	179.5	179.3
June	117.2	121.1	83.2	82.7	180.5	178.9

Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	320.7	320.7	95.47	95.47	26.76	26.76	25.83	25.83
February	320.4	320.5	101.94	101.93	26.90	26.86	26.84	26.80
March	320.3	320.1	105.34	106.15	27.53	27.37	27.71	27.34
April	320.5	320.8	102.96	106.93	26.84	28.30	27.46	27.33
May	320.8	321.8*	102.43	106.85	26.75	29.95	27.18	27.25
June	321.4	322.6	104.16	103.96*	27.13	28.93*	27.34	27.48*
July	322.5	323.4	104.79	102.49	27.52	28.31	27.52	27.73
August	323.0	324.3	106.24	104.43	28.07	28.96	27.50	28.22
September	323.8	325.3	108.63	107.26	28.84	29.21	27.92	28.46
October	325.3	326.4	102.97	104.13	26.95	27.64	27.76	27.58
November	326.4	327.5	104.42	103.85	27.15	27.52	28.31	27.69
December	327.2	328.8	104.93	105.43	27.46	28.11	29.11	27.88
January 1988	329.1	330.5	106.05	106.11	27.93	28.27	27.63	28.13
February	330.6	332.4	106.17	106.84	27.86	28.43	27.85	28.31
March	331.8	333.9	105.95	108.27	27.74	28.92	28.18	28.49
April	333.6	335.2	105.24	108.92	27.05	29.12	28.65	28.45
May	335.4	336.7	103.46	108.53	25.93	29.18	28.43	28.86
June	337.4	338.0	104.21	109.58	26.28	29.43	29.06	29.16

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	659.0	659.0	8.27	8.28	126.5	126.5	79.4	79.4
February	660.2	660.5	8.40	8.40	127.1	127.2	79.7	79.7
March	662.8	663.0	9.87	9.87	126.7	127.3	79.2	79.6
April	662.9	664.3	8.93	8.75	126.5	127.2	78.8	79.4
May	663.5	666.9*	9.08	9.20	127.1	127.8	79.1	79.6
June	664.9	668.8	9.25	9.23*	127.6	128.1*	79.3	79.7*
July	666.8	670.5	9.20	9.28	127.8	128.3	79.3	79.7
August	668.5	672.1	9.30	9.35	127.9	128.6	79.2	79.8
September	670.6	675.0	9.34	9.53	128.1	128.8	79.2	79.8
October	673.4	679.5	9.45	9.47	128.6	129.2	79.4	80.0
November	675.9	681.8	9.40	9.50	129.0	129.5	79.5	80.0
December	678.1	684.3	9.30	9.53	129.4	129.7	79.7	80.0
January 1988	681.4	687.9	9.36	9.58	129.0	129.9	79.3	80.0
February	684.5	692.3	9.46	9.62	128.7	129.9	78.9	79.8
March	687.2	695.4	9.57	9.67	129.2	130.2	79.1	79.9
April	691.4	698.1	9.60	9.73	129.5	130.4	79.2	79.9
May	694.8	701.2	9.65	9.80	129.7	130.6	79.2	79.9
June	697.0	703.9	9.71	9.85	129.6	130.9	79.0	80.0

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PRICES

	CPI-U (seasonally adjusted)		PPI Finished Goods (seasonally adjusted)		PPI-Industrial Commodities (unadjusted)		Estimated GNP Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	333.6	333.6	291.7	291.7	313.6	313.5	116.0	116.0
February	335.0	335.0	291.9	291.9	315.7	315.7	116.2	116.3
March	336.3	336.3	293.1	293.1	315.8	315.8	116.5	116.8
April	337.5	337.6	294.7	295.2	316.4	317.4	116.9	117.3
May	338.8	338.7	296.0	296.1	316.9	318.6	117.3	117.8
June	339.5	339.7*	297.3	296.7*	317.1	319.2*	117.7	118.1*
July	340.9	340.6	298.5	297.5	317.9	320.1	118.0	118.6
August	342.2	341.5	299.8	298.3	319.2	321.6	118.4	119.0
September	343.5	342.9	300.6	299.5	317.2	319.3	118.8	119.4
October	344.7	344.3	301.5	300.7	319.8	322.9	119.2	119.9
November	345.9	345.5	302.3	301.6	320.5	324.0	119.5	120.3
December	347.2	346.9	303.1	303.0	321.3	325.3	119.9	120.8
January 1988	348.2	348.0	303.8	303.8	322.9	326.5	120.4	121.2
February	349.3	349.4	304.5	304.9	324.5	327.8	121.0	121.6
March	350.4	350.9	305.2	306.1	326.0	329.3	121.6	122.0
April	351.9	352.2	306.0	307.0	325.6	330.5	121.9	122.5
May	353.7	353.5	306.9	307.9	326.5	331.6	122.2	122.9
June	355.5	355.1	307.8	309.0	327.7	332.8	122.6	123.4

	Consumption Deflator		Consumer Durables		Consumer Nondurables		Consumer Services		Implicit Construction Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	116.5	116.5	106.0	106.0	109.2	109.2	124.8	124.8	110.6	110.6
February	116.8	116.8	106.4	106.5	109.8	109.7	125.2	125.2	110.9	110.9
March	117.2	117.3	106.4	106.7	110.2	110.2	125.6	125.6	111.1	111.1
April	117.7	117.8	106.7	106.9	110.7	110.9	126.1	126.1	111.4	111.2
May	118.1	118.3*	107.1	107.2*	111.1	111.4*	126.6	126.6*	111.7	111.4*
June	118.5	118.7	107.5	107.6	111.5	111.8	127.1	127.0	112.0	111.7
July	119.0	119.1	107.9	107.9	111.9	112.2	127.5	127.5	112.3	112.0
August	119.5	119.5	108.2	108.2	112.2	112.5	128.0	128.0	112.6	112.4
September	119.9	120.0	108.5	108.5	112.5	112.9	128.6	128.6	112.8	112.6
October	120.4	120.5	108.9	109.0	112.9	113.2	129.2	129.2	113.1	112.8
November	120.8	120.9	109.3	109.3	113.4	113.6	129.7	129.7	113.5	113.0
December	121.2	121.4	109.7	109.7	113.8	114.0	130.2	130.3	113.9	113.3
January 1988	121.7	121.8	110.0	110.1	114.2	114.3	130.7	130.8	114.2	113.6
February	122.2	122.3	110.2	110.5	114.6	114.7	131.2	131.3	114.4	113.7
March	122.6	122.8	110.5	110.8	115.0	115.1	131.8	131.9	114.7	114.0
April	123.1	123.3	110.8	111.1	115.5	115.5	132.4	132.5	115.0	114.2
May	123.6	123.7	111.2	111.4	115.9	115.9	133.0	133.0	115.3	114.5
June	124.0	124.2	111.5	111.8	116.4	116.4	133.6	133.6	115.8	114.8

Fore. = May Forecast
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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 $)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	-12.27	-12.27	186.0	185.6	4308	4316	3714	3721	-9.9	-9.6
February	-15.06	-15.06	186.8	186.3	4349	4359	3743	3748	-7.7	-7.0
March	-14.15	-13.63	187.5	187.7	4361	4380	3743	3750	-7.6	-7.1
April	-14.89	-13.32	188.3	186.6	4372	4397	3740	3749	-8.0	-9.6
May	-14.50	-13.27p	187.8	187.5	4398	4423	3749	3755	-8.3	-10.5
June	-14.21	-13.06*	187.7	188.0*	4423	4438	3758	3758	-8.6	-11.3
July	-14.96	-12.27	188.0	188.3	4440	4462	3763	3762	-9.8	-11.7
August	-14.70	-12.83	187.7	188.6	4465	4485	3771	3769	-10.2	-11.5
September	-14.44	-12.94	188.3	188.7	4491	4522	3780	3787	-9.3	-11.0
October	-14.08	-13.36	187.7	188.1	4516	4545	3789	3791	-10.5	-9.4
November	-13.91	-12.83	187.5	188.3	4535	4560	3795	3791	-10.8	-9.2
December	-13.73	-12.81	187.9	188.0	4557	4589	3801	3799	-11.1	-8.6
January 1988	-13.68	-12.52	188.4	187.8	4582	4626	3806	3817	-15.4	-8.8
February	-13.51	-13.53	188.5	188.1	4610	4656	3810	3829	-17.6	-9.2
March	-13.33	-12.67	188.2	188.4	4633	4678	3810	3834	-19.8	-9.5
April	-13.26	-12.52	187.8	187.8	4660	4695	3823	3833	-16.5	-9.8
May	-13.53	-12.17	187.3	187.5	4686	4732	3835	3850	-15.4	-10.4
June	-13.26	-11.85	187.0	187.8	4716	4757	3847	3855	-14.6	-10.8

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FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	258.8	258.9	737.6	737.6	2822.0	2822.0	6.43	6.43	5.44	5.44
February	259.3	259.0	737.2	737.2	2821.5	2821.5	6.10	6.10	5.59	5.59
March	260.5	260.1	739.2	739.2	2825.6	2825.7	6.13	6.13	5.60	5.60
April	262.0	262.2	750.1	750.2	2845.2	2839.6	6.38	6.37	6.05	5.90
May	263.3	263.6	754.4	753.3	2867.5	2844.8	6.68	6.85	6.11	6.05
June	264.5	264.2*	758.7	749.9*	2889.3	2851.4*	6.71	6.72*	6.10	6.04*
July	266.4	265.5	760.4	753.8	2901.4	2866.2	6.76	6.73	6.18	6.00
August	268.2	267.4	762.5	761.8	2912.9	2889.6	6.79	6.36	6.25	5.83
September	270.0	268.8	764.6	766.6	2924.3	2909.8	6.78	6.27	6.23	5.76
October	271.3	269.8	769.3	770.3	2943.2	2926.8	6.75	6.51	6.11	5.94
November	272.6	271.0	773.9	772.9	2961.9	2940.7	6.72	6.73	6.15	5.98
December	273.6	272.5	778.5	776.4	2979.7	2954.0	6.69	6.85	6.15	6.03
January 1988	275.1	273.9	784.6	778.4	2995.4	2968.8	6.57	6.83	6.01	6.11
February	276.7	275.3	790.3	783.2	3014.3	2987.1	6.55	7.04	5.98	6.24
March	278.2	276.6	796.0	786.9	3033.6	3008.0	6.61	7.16	6.06	6.27
April	280.2	277.8	800.1	789.5	3049.2	3023.0	6.76	7.25	6.17	6.29
May	282.1	279.3	804.2	793.2	3064.5	3041.1	6.88	7.23	6.30	6.25
June	284.0	280.8	807.8	797.5	3079.8	3062.4	7.01	7.26	6.32	6.28

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	8.36	8.36	6.61	6.61	5.84	5.84	5.87	5.87	7.50	7.50
February	8.38	8.38	6.61	6.61	6.05	6.05	6.10	6.10	7.50	7.50
March	8.36	8.36	6.66	6.66	6.16	6.16	6.17	6.17	7.50	7.50
April	8.93	8.85	7.56	7.55	6.43	6.45	6.56	6.52	7.74	7.75
May	9.20	9.33	7.82	8.00	6.72	6.93	6.81	6.99	8.19	8.14
June	9.53	9.33*	8.15	7.81*	6.80	6.85*	6.89	6.92*	8.25	8.25*
July	9.48	9.08	8.09	7.54	6.83	6.80	6.95	6.86	8.25	8.25
August	9.50	8.82	8.10	7.29	6.85	6.64	7.02	6.75	8.25	8.25
September	9.42	8.96	8.01	7.35	6.79	6.60	7.05	6.71	8.25	8.25
October	9.34	9.13	7.89	7.58	6.75	6.67	7.01	6.78	8.25	8.25
November	9.29	9.35	7.80	7.78	6.70	6.85	6.97	6.93	8.25	8.46
December	9.25	9.52	7.75	7.95	6.67	7.02	6.90	7.13	8.25	8.67
January 1988	9.12	9.56	7.62	8.01	6.54	7.05	6.74	7.16	8.25	8.75
February	9.15	9.53	7.62	8.01	6.57	7.09	6.75	7.20	8.25	8.75
March	9.13	9.48	7.62	7.92	6.65	7.16	6.81	7.25	8.25	8.75
April	9.32	9.45	7.85	7.87	6.78	7.29	6.99	7.38	8.25	8.75
May	9.35	9.43	7.87	7.85	6.93	7.28	7.08	7.39	8.25	8.75
June	9.43	9.28	7.97	7.70	7.04	7.33	7.22	7.43	8.25	8.93

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MONTHLY PROJECTIONS
July 1987

Dr. Donald Ratajczak, Director
For Release: July 29, 1987

DATA REVISIONS INCREASE IMPORTANCE OF SERVICE ECONOMY

According to the latest annual revisions of the GNP, service purchases have been significantly understated over the past three years. Much of this is the result of sharp gains in rental activity, especially for home entertainment items such as videos, which have not been adequately incorporated in the regular spending surveys. Because of data revisions, economic activity in the first quarter was 0.9% higher after inflation than originally reported.

Construction expenditures also were revised significantly upward, with the brunt of this revision occurring in the additions and alterations of residential activity. This segment of construction expenditures now accounts for more than one-quarter of total construction spending. As a result, the relationship between housing starts and construction expenditures needs to be adjusted modestly. The construction deflator also was revised upward, but the overall GNP deflator was virtually unchanged. Because of shifts in composition, the implicit deflator for consumer durables was lower than originally recorded while the consumer services index was slightly higher. However, the overall consumption deflator was little changed from previous estimates. Moreover, our estimates of the overall GNP deflator showed little change.

Capital spending grew about a percentage point per year less than originally expected over the past three years while inventory holdings are about a percentage point higher than reported in the unrevised data. Thus, business inventories have not been depleted as rapidly as earlier expected, although the rate of inventory accumulation slowed in the second quarter as auto inventories were no longer being accumulated.

Personal income also was revised upward sharply. The increase in consumer outlays had no adverse effect upon personal savings. Indeed, a more than $20 billion upward revision in wages and salaries and a more than $40 billion increase in interest income were more than sufficient to offset increased ser-

vice outlays. However, these income gains were at the expense of corporate earnings. Indeed, our stock market formula would suggest an even greater vulnerability to decreases in stock values than was the case with the previously reported data.

While economic activity was being revised upward, employment and the index of hours worked had been revised downward as a result of their benchmark adjustments. Thus, productivity has not been as anemic as originally reported. Nevertheless, productivity gains still remain very modest in comparison to gains during the 1950's and 1960's. There also may be a slight distortion in the manufacturing productivity data. In recent years, a rising percentage of all manufacturing employment has been procured by lease or using temporaries. However, this renting of labor services is counted in the service sector rather than in the manufacturing sector. As a result, the amount of resources in manufacturing that are being used to provide manufacturing activity are diminished relative to the amount of activity that is being accomplished. This causes a significant increase in manufacturing productivity at the expense of productivity performance in the service economy.

Because of upward revisions in economic activity and downward revisions in capital spending over the previous three years, an upward revision in capacity utilization may be forthcoming. Even so, the utilization level should remain only slightly above 80%. However, as industrial activity continues to expand, increased spending on plant and equipment may develop. Thus, growth in producers' durables may combine with reductions in the trade deficit to provide significant economic stimulus in the next six to twelve months even as consumer spending grows at reduced rates.

Normally, a slowing in construction activity and some moderation in inventory accumulation would lead to some softening in interest rate pressures. However, the Federal Reserve apparently has "snugged" up as growth in the monetary base has slowed sharply in the past three months. In addition, higher interest rates have increased the attractiveness of noncheckable deposits for holding short-term liquidity. This has caused the money multiplier to fall, leading to virtually no growth in monetary aggregates over the past three months. Indeed, the Federal Reserve probably is currently following an interest rate target rule while the confirmation of Alan Greenspan continues to be discussed in the Senate. The softening of economic activity when an interest rate rule is used generally leads to reduced growth in monetary aggregates as the Federal Reserve is put in the unexpected position of propping up short-term interest rates.

Despite downward pressures upon short-term interest rates, long-term interest rates continue to increase. Inflationary concerns remain near the surface, while a run-up in the price of oil early in July accounted for some of the poor interest rate performance. Later in July, concerns began to be raised about foreign reception of the government funding and the huge supply of bonds and notes that will need to be absorbed following resolution of the latest debt limitation crisis.

The latest concern about foreign investors is caused by a modest narrowing of interest rate differentials between Japan and the United States. As the dollar has rallied against the yen in the past month, and is now trading around the 150 yen range, potential further appreciation of the dollar is expected to be minimal. The prevailing 4 percentage point differential between yields on

Japanese and American debt instruments may not provide enough insurance to offset fears of dollar declines in the future. Therefore, Japanese investors may not be as aggressive in bidding for American securities as in the past. Moreover, rapid money growth in Japan during recent months has begun to stimulate domestic activity there. As a result, the quantity of savings available for foreign investments may diminish slightly. Nevertheless, unusually high yields on U.S. government securities, approaching 9%, should entice lenders in the United States to enter the market. After all, the inflation rate probably has slowed to a 4% path for the next six to twelve months, suggesting that an unusually high return adjusted for inflation currently exists in U.S. government bonds.

Although supply problems are substantial and will probably prevent any significant rebound in government bond prices before the middle of August, developing favorable near-term trends in the inflationary outlook should prove to be beneficial to fixed income investors. Our PPI survey for July shows no change in prices of finished goods. The Journal of Commerce index of industrial prices currently is moving down toward 98 from a high of slightly over 100 early in July. Moreover, the hourly earnings index continues to show only very modest increases from the previous year, growing only 2.3% from a year ago in the latest reporting month.

While the longer term trend for interest rates is probably upward, rates have increased more rapidly than fundamentals have deteriorated. For that reason, a slight rally in the bond market should be anticipated by the beginning of fall.

Quarterly Profile of GNP

	1987-1	1987-2	1987-3	1987-4	1988-1	1988-2	1987 Annual	1988 Annual
Real:	4.4	2.6	3.0	2.5	2.5	2.3	2.6	2.5
Price:	4.3	3.8	4.2	4.5	4.4	4.4	3.6	4.4
Nominal:	8.9	6.5	7.3	7.1	7.0	6.7	6.3	7.0

Monthly Statistical Highlights for July 1987

Payroll employment +167,000; index of hours worked +0.2%; household employment +261,000; civilian unemployment rate 6.3%; personal income +0.5%; savings rate 4.1%; personal consumption +0.5%; retail sales +0.3%; auto sales 10.0 million units; housing starts +0.1%; housing permits -1.1%; construction expenditures -0.6%; business inventories +0.5%; orders for durable goods +0.4%; orders for nondefense capital goods +2.3%; industrial production +0.2%; CPI +0.3%; PPI -0.0%; consumption deflator +0.4%; leading indicators +0.3%; real GNP (AR) +4.5%; M1 (AR) +0.6%; M2 (AR) +5.1%.

Monthly Statistical Highlights for August 1987

Payroll employment +166,000; index of hours worked +0.2%; household employment +153,000; civilian unemployment rate 6.3%; personal income +0.6%;

savings rate 4.2%; personal consumption +0.4%; retail sales +0.2%; auto sales 10.1 million units; housing starts +0.2%; housing permits +0.6%; construction expenditures +0.6%; business inventories +0.5%; orders for durable goods -1.6%; orders for nondefense capital goods -1.7%; industrial production +0.2%; CPI +0.3%; PPI +0.1%; consumption deflator +0.3%; leading indicators +0.2%; real GNP (AR) +1.6%; M1 (AR) +5.3%; M2 (AR) +6.2%.

Commentary

Employment - As expected, the unusually early survey caused a drop in household employment in June and a significant drop in the teenage unemployment rate. In addition, payroll employment grew more slowly than in previous months. However, along with distortions caused by the unusually early survey, some signs of reduced employment demand surfaced. The workweek shortened slightly and reduced growth in payrolls was even sharper than could be explained by an unusually short survey period. The survey in July is relatively late in the month, which should generate higher than normal payroll employment. However, the reduced demand for labor input may restrain employment growth. In particular, employment gains are beginning to slow in the previously hot areas of eating out and business services. The household report will show a rebound in employment with a much larger rebound in the labor force as teenage unemployment moves back to where it was in May. As a result, the unemployment rate will rise and the report will appear slightly weak.

Nevertheless, the diffusion index continues to reveal modest growth, especially when the shortened survey period is considered. In addition, the hourly earnings index remains only 2.3% above previous year levels and shows no tendency to accelerate at the present time.

Personal Income and Outlays - As mentioned above, revisions in personal income were approximately $20 billion in wages and salaries, $5 billion in rental income, $40 billion in interest income, and more than $20 billion in farm income. Because of the sharp upward revision in farm income, there was less room for gains from shifts in farm subsidies. Thus, growth in personal income for June was less than anticipated, but such anticipations would have not been as robust if revised incomes had been known. The June report also showed an unusual $4 billion drop in social security outlays. Obviously, such a decline is not anticipated in July.

Also as mentioned above, most of the increased outlays from the revised data were in the service sector. However, a large increase in home improvement materials also caused a significant upward revision in durables. Hot weather and a reinvigorated stock market caused a significant rebound in services during June. Similar growth in service expenditures may be forthcoming in July before the service component moderates during the fall. Expenditures for nondurables are surprisingly weak especially as prices have begun intensifying for gasoline and food product. Apparently, a significant decline in the volume of gasoline and fuel oil sales is occurring. As energy prices stabilize in the second half of the year, the volume of petroleum product expenditures should resume modest upward growth.

Automobile sales appear to be stuck at 10 million units despite efforts to stimulate sales with incentives. A new burst of incentives is expected to close

out the model year in September. The sales surge, however, is not expected to be as dramatic as last year, although it will be borrowing from sales in the next few months. With more than 135 million registered automobiles, replacement demand probably is approaching 10 million units. Thus, auto sales should gradually improve following the incentive distortions anticipated at the end of this model year.

Furniture sales are beginning to weaken notably as a result of the weakness in housing activity. Because housing is expected to fall further in the latter part of 1987, furniture sales should remain weak into the first part of 1988. This is a significant deviation from our previous forecast, but it is necessitated by the dramatic slowing in housing activity following increased mortgage rates during April and May.

Construction - Housing sales fell dramatically in May as a result of a sharp increase in interest rates. A modest sales rebound probably developed in June, although the data are not yet available. Single-family activity fell sharply in May and June in response to this weak sales environment. A slight rebound in activity is now anticipated as buyers become more accepting of double-digit mortgage rates. Nevertheless, no significant resurgence is anticipated. Apartment activity was stronger than expected in June, but this appears to be a temporary rebound, as permits for rental units fell significantly. Our current projections suggest that most of the damage already has occurred in housing starts, but the lagged response of expenditures to these changes in starts will continue to exert downward pressures upon construction expenditures through the summer.

Revisions in construction expenditures were largely in the residential area and are largely related to alterations and additions. As a result, a higher constant term is required to generate construction expenditures from housing starts. The result of this is to permanently increase the level of construction expenditures relative to housing activity. On the other hand, public construction has stalled despite increased outlays for highway activity. This appears to be the result of budgetary restraints that will continue to exert a moderating influence upon public construction during the next year. The rebound in nonresidential construction during May is surprising and appears to be at least partially concentrated in shopping centers and other retail activity. Commercial activity is falling. Although some industrial growth is anticipated, weakness in retail construction should exert downward pressures upon nonresidential expenditures in the remainder of the year.

The upward revision in prices for construction product also increased the growth of construction prices over the first five months. As a result, higher construction deflators are necessary in our projections. This, of course, means that construction dollars will not be as easily translated into real activity as prior to the revision.

Business Activity - The surprising spurt in wholesale inventories during May was primarily responsible for the better GNP gains in the second quarter than originally anticipated. Indeed, our estimates of changes in final demand were precisely the 3.3% reported for the quarter. Although automobile inventories were not accumulated, manufacturing parts at the wholesale level grew sharply. This appears to be in response to increased delivery delays and rising prices for industrial materials. Now that those prices are beginning to moderate, business inventories probably will grow more slowly during the summer months. However,

increased manufacturing activity will require an increase in manufacturers' inventories. The effect will be a moderation in inventory investment in the third quarter, but only by a small amount.

Defense orders continued to swell and are now more than $1.3 billion above shipments. This will accelerate the growth of shipments next year, but will also require a slowing in defense orders in the months ahead. Thus, there should be little further gain in durable goods orders in the next twelve months. Orders for nondefense capital goods have been vacillating as a result of intermittant large orders for commercial aircraft. Aircraft orders were relatively light in June but should rematerialize in July. Of course, these aircraft orders should have limited effect upon shipments of capital goods in the months ahead. Nevertheless, the buildup of a backlog will cause further increases in capital shipments. Thus, capital spending activity is now expected to grow more than 3% after adjustment for inflation in the next twelve months.

The strength in durable goods activity and in inventory accumulations will be reflected in stronger gains for industrial production than anticipated in our previous forecast. The industrial sector is expected to grow almost as rapidly as overall GNP, a far cry from a year ago when a 2.9% increase in GNP corresponded with only a 0.6% gain in the industrial production index.

Prices -- Price revisions in the new GNP accounts were relatively modest. Those that occurred already have been explained above. It now appears that inflationary pressures are diminishing despite slightly further gains in petroleum product. However, oil should only sell between $1.5 - $2 above the Persian Gulf wellhead price in the United States. Given the $18 wellhead price, this would mean a price below $20. However, tension in the Persian Gulf caused a premium on oil prices. This premium will slowly diminish as it becomes clear that oil will be flowing freely in that part of the world. Thus, the oil shock probably is behind us for the remainder of this year. In addition, the meat shock is rapidly coming to an end. Although prices of industrial materials are continuing to rise unusually rapidly, inflationary dangers probably will diminish in the second half of this year.

Miscellaneous - The trade deficit in May was less than forecast but more than anticipated following further dollar weakening and the favorable April trade performance. Oil imports rebounded but so did automobiles. However, automobile imports may be the beginning of a Japanese model year. Further increases are anticipated in oil imports but other imports of manufactured goods should begin to decline. The dollar's strength should lower overall trade deficits next year.

The leading indicators should continue to grow rapidly as sharp gains in sensitive prices offset significant declines in the real money stock. If the stock market peaks toward the fall, as expected, and if sensitive prices begin to moderate, the leading indicators should top out some time in the fall.

Financial Markets

The result of the data revisions is to show greater corporate need for funds than had previously been expected. Although fixed investment is not as robust, inventory investment is more substantial. In addition, corporate cash flow appears to be less than originally anticipated. This is partially offset

by higher savings in the household sector, although increased consumption diminishes the magnitude of savings improvement there. Thus, the data revisions reveal a greater need for funds by domestic private industry than previously expected. This may partially explain the vigor by which interest rates moved up in the spring when new inflationary fears surfaced.

Corporate profits should grow substantially during the second half of 1987 while inventory investments should show minimal change. Although fixed investment will continue to expand, this suggests that the corporate sector will be exerting less pressures upon interest rates than previously. Although the government will be borrowing significantly following its unexpected revenue gains as a result of capital gains transactions during the spring, most of this increased government deficit will be mirrored by increased household savings. Thus, the net near-term effect of the deficit on interest rate increases in the summer will be modest. With mortgage borrowings declining as a result of reduced housing demand, the household sector will significantly increase its net contribution to the credit markets. This means that foreign use of funds will be much less significant in the summer and fall than originally anticipated. Indeed, such an economic environment could justify a modest decline in interest rates.

Also, the Federal Reserve has become more restrictive in recent months. Monetary aggregates are growing well below Federal Reserve targets and the monetary base has slowed to less than a 6% growth path over the past thirteen weeks. Currency demand remains relatively vigorous, suggesting that much of the slowing in monetary aggregates is merely the result of shifting savings portfolios. Nevertheless, the Federal Reserve probably will feel that restraint is no longer needed at the present time. When corporate borrowing needs diminish slightly, this could lead to declining short-term interest rates in the fall. These rates are not expected to decline dramatically and should reverse direction and begin rising again early in 1988.

It should also be noted that the decline in deficits will be coming to an end after only a one-year downward trend. Unless significant budgetary restraint or revenue-raising activity develops in 1988, an unlikely event during an election year, the government deficit probably will rise about $10 billion from an anticipated $160 billion level in the current fiscal year.

On the other hand, the household sector probably will continue to restrain housing purchases and gradually rebuild savings accounts. Thus, the household sector's contribution to credit market conditions may nearly offset the government's increased desire for borrowings. If the corporate sector modestly reduces its need for funds, the bond markets will have less reliance upon foreign investments. However, economic conditions probably will again reassert upward pressures upon interest rates early in 1988.

Equity Markets - According to data revisions, stock market values already are excessive. However, earnings are improving dramatically while expected interest rates are no longer increasing. Under those conditions, a modestly higher stock market evaluation is certainly possible. However, this improved equity evaluation will only continue until interest rates begin moving upward again and earnings begin to show weakened year over year comparisons by the beginning of 1988.

The dollar's rebound in recent weeks reduces opportunities in the chemicals and forest products industries. In addition, the retrenchment expected by the

consumer suggests that consumer-based products will have diminished opportunities. Even interest-sensitive securities will be struggling late this year and early next year as interest rates continue to rise.

However, some of the cyclical industrial material companies, such as plastics, rubber, and even the nonprecious nonferrous metals may do reasonably well in the next twelve months. In addition, capital goods producers may receive increased valuations. Thus, opportunities still remain in the equity markets, but the range of opportunities is clearly diminishing. A decline in equity values still is anticipated late this year and early in 1988, when the stock market may fall toward the 2000 level.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	101626	100919	119.9	118.7	111011	111011	6.7	6.7	170.7	171.2
February	101862	101150	120.9	119.7	111382	111382	6.7	6.7	171.4	171.8
March	102026	101329	120.4	119.6	111368	111368	6.6	6.6	171.8	172.2
April	102263	101598	120.7	119.6	111643	111835	6.5	6.3	172.2	172.6
May	102479	101672	121.0	120.2	111903	112447	6.5	6.3	172.7	172.7
June	102695	101788	121.3	120.1	112178	112257	6.4	6.1	173.1	173.1
July	102837	101953*	121.5	120.3*	112321	112418*	6.4	6.3*	173.6	173.5*
August	102973	102119	121.5	120.5	112485	112571	6.4	6.3	174.0	173.9
September	103109	102247	121.6	120.6	112286	112870	6.6	6.2	174.4	174.4
October	103295	102349	121.8*	120.7	112627	112975	6.6	6.2	174.9	174.8
November	103476	102545	122.1	120.9	112917	113211	6.5	6.2	175.4	175.3
December	103654	102749	122.4	121.1	113208	113597	6.5	6.0	175.8	175.7
January 1988	103789	102971	122.5	121.3	113356	113604	6.6	6.1	176.5	176.2
February	103927	103141	122.6	121.5	113483	113784	6.7	6.1	177.3	176.7
March	104065	103378	122.5	121.8	113442	114033	6.6	6.0	178.2	177.3
April	104228	103565	122.8	122.0	113725	114246	6.5	5.9	178.6	177.7
May	104410	103753	123.2	122.2	113902	114454	6.5	5.9	179.1	178.2
June	104592	103864	123.4	122.3	114091	114540	6.5	5.9	179.6	178.8

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	3.553	3.632	2.129	2.150	118.8	150.3	3.024	3.094	2.905	2.943
February	3.599	3.671	2.145	2.166	103.2	128.6	3.075	3.138	2.972	3.010
March	3.604	3.683	2.153	2.173	105.6	136.4	3.087	3.146	2.981	3.010
April	3.619	3.700	2.163	2.182	100.3	32.9	3.095	3.067	2.995	3.034
May	3.634	3.718	2.172	2.193	97.2	146.4	3.107	3.176	3.010	3.030
June	3.650	3.731	2.180	2.201	90.4	122.3	3.115	3.173	3.025	3.050
July	3.665	3.751*	2.190	2.211*	85.2	130.0*	3.126	3.195*	3.041	3.065*
August	3.679	3.772	2.201	2.222	79.6	134.1	3.137	3.212	3.058	3.078
September	3.695	3.790	2.209	2.231	75.6	113.4	3.148	3.221	3.073	3.108
October	3.717	3.808	2.218	2.240	73.5	142.3	3.162	3.240	3.089	3.098
November	3.733	3.827	2.232	2.251	69.7	135.4	3.176	3.254	3.106	3.119
December	3.750	3.848	2.245	2.262	65.3	133.1	3.190	3.270	3.125	3.137
January 1988	3.756	3.860	2.254	2.273	85.6	145.5	3.226	3.300	3.141	3.155
February	3.779	3.880	2.264	2.285	90.3	155.1	3.243	3.323	3.153	3.168
March	3.805	3.903	2.275	2.299	99.7	153.3	3.268	3.343	3.168	3.185
April	3.824	3.923	2.286	2.310	96.3	160.4	3.285	3.360	3.189	3.200
May	3.844	3.942	2.298	2.321	93.5	154.2	3.297	3.373	3.204	3.219
June	3.863	3.963	2.307	2.333	90.4	152.2	3.310	3.388	3.220	3.236

Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections

CONSUMPTION

	Personal Consumption		Durables		Nondurables		Services		Consumption Real	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	2806.6	2849.5	364.8	381.9	946.8	954.4	1495.0	1513.2	2408.9	2446.7
February	2873.7	2915.8	394.3	405.7	970.0	980.3	1509.3	1529.8	2460.0	2496.9
March	2882.6	2916.0	397.2	400.7	971.6	975.1	1513.9	1540.1	2459.3	2484.3
April	2895.8	2939.7	395.1	411.6	976.5	979.3	1524.2	1548.8	2460.3	2497.0
May	2910.0	2935.9	394.2	403.8	980.8	977.3	1535.0	1554.7	2464.0	2481.2
June	2925.4	2956.3	396.9	413.6	985.1	974.4	1543.4	1568.3	2467.7	2488.1*
July	2941.0	2971.2*	399.2	413.7*	989.3	979.6*	1552.5	1577.9*	2471.4	2491.0
August	2958.5	2983.4	402.3	413.9	994.6	982.1	1561.6	1587.4	2475.7	2492.5
September	2972.7	3012.8	405.5	430.8	996.6	985.4	1570.6	1596.6	2480.0	2509.8
October	2988.2	3002.6	407.6	407.9	1000.9	989.0	1579.7	1605.7	2481.9	2490.5
November	3005.1	3023.3	409.1	414.5	1006.5	993.4	1589.5	1615.4	2487.7	2498.1
December	3023.9	3041.3	410.5	417.2	1013.0	997.8	1600.4	1626.3	2493.2	2503.9
January 1988	3039.0	3058.5	412.4	419.9	1017.3	1002.8	1609.3	1635.8	2497.1	2509.2
February	3051.3	3071.6	414.4	420.3	1018.8	1006.2	1618.1	1645.1	2497.0	2509.6
March	3064.8	3088.1	416.3	423.5	1021.7	1009.9	1626.8	1654.7	2500.8	2513.8
April	3085.8	3102.6	417.8	424.0	1028.5	1013.5	1639.5	1665.1	2506.7	2515.8
May	3100.5	3121.4	417.1	427.4	1034.0	1018.2	1649.4	1675.8	2508.5	2521.3
June	3115.7	3137.9	417.0	428.7	1039.5	1023.0	1659.2	1686.2	2509.4	2523.9

RETAIL SALES

	Retail Sales		Non-Auto Durables		Auto (Million Units)		Nondurable Sales		Auto Sales	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	118.58	118.58	20.04	20.04	8.2	8.2	74.81	74.81	23.73	23.73
February	124.41	124.28	20.76	20.40	9.9	9.9	76.73	76.92	26.93	26.97
March	124.67	124.59	20.65	20.16	10.2	10.2	76.82	76.65	27.20	27.78
April	125.04	124.96	20.80	20.03	10.0	10.4	77.20	76.83	27.04	28.10
May	125.12	124.55	20.75	20.07	9.6	9.7	77.54	76.86	26.83	27.61
June	125.88	125.08	20.72	19.98	9.9	9.9	77.88	76.97	27.28	28.13
July	126.64	125.50*	20.88	19.86*	10.0	10.0*	78.22	77.38*	27.54	28.26*
August	127.38	125.72	21.06	19.80	10.0	10.1	78.63	77.58	27.69	28.34
September	127.65	127.95	21.23	19.85	9.9	10.8	78.79	77.84	27.63	30.26
October	128.47	125.57	21.30	19.79	10.0	9.5	79.13	78.12	28.04	27.66
November	129.16	126.68	21.33	19.70	10.1	9.8	79.58	78.47	28.25	28.51
December	130.02	127.35	21.15	19.84	10.3	9.9	80.09	78.82	28.78	28.69
January 1988	130.63	128.05	21.34	19.71	10.3	10.1	80.43	79.21	28.86	29.13
February	130.92	128.37	21.45	19.63	10.3	10.1	80.55	79.48	28.92	29.26
March	131.08	128.98	21.53	19.60	10.2	10.3	80.78	79.72	28.77	29.56
April	131.97	129.38	21.57	19.57	10.2	10.3	81.31	80.06	29.09	29.75
May	132.41	130.15	21.65	19.64	10.1	10.4	81.75	80.43	29.01	30.08
June	132.85	130.68	21.62	19.68	10.1	10.4	82.18	80.81	29.05	30.19

Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	320.7	320.7	95.47	95.47	26.76	26.76	25.83	25.83
February	320.4	320.5	101.94	101.93	26.90	26.86	26.84	26.80
March	320.3	320.1	105.34	106.21	27.53	27.40	27.71	27.35
April	320.5	320.8	102.96	106.93	26.84	28.30	27.46	27.33
May	320.8	321.5	102.43	106.98	26.75	29.99	27.18	26.95
June	321.4	321.9*	104.16	108.53	27.13	29.09	27.34	27.61
July	322.5	322.5	104.79	108.96*	27.52	29.76*	27.52	27.88*
August	323.0	323.2	106.24	107.23	28.07	29.24	27.50	28.13
September	323.8	324.1	108.63	105.92	28.84	28.63	27.92	28.16
October	325.3	324.9	102.97	105.51	26.95	27.84	27.76	27.95
November	326.4	326.2	104.42	106.65	27.15	28.63	28.31	28.16
December	327.2	327.5	104.93	107.41	27.46	28.89	29.11	28.43
January 1988	329.1	328.8	106.05	107.14	27.93	28.36	27.63	28.05
February	330.6	329.9	106.17	107.69	27.86	28.65	27.85	28.62
March	331.8	331.3	105.95	109.23	27.74	29.15	28.18	28.69
April	333.6	332.2	105.24	109.85	27.05	29.63	28.65	29.13
May	335.4	333.1	103.46	108.76	25.93	29.54	28.43	29.28
June	337.4	334.5	104.21	109.78	26.28	29.65	29.06	29.46

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	659.0	659.0	8.27	8.28	126.5	126.5	79.4	79.4
February	660.2	660.5	8.40	8.40	127.1	127.2	79.7	79.7
March	662.8	663.0	9.87	9.87	126.7	127.3	79.2	79.6
April	662.9	665.9	8.93	8.76	126.5	127.3	78.8	79.4
May	663.5	670.4	9.08	9.23	127.1	128.0	79.1	79.7
June	664.9	673.6*	9.25	9.36	127.6	128.2	79.3	79.7
July	666.8	677.1	9.20	9.51*	127.8	128.5*	79.3	79.8*
August	668.5	680.2	9.30	9.66	127.9	128.8	79.2	79.9
September	670.6	682.9	9.34	9.64	128.1	129.0	79.2	79.9
October	673.4	684.9	9.45	9.53	128.6	129.1	79.4	79.8
November	675.9	688.3	9.40	9.60	129.0	129.5	79.5	80.0
December	678.1	691.7	9.30	9.58	129.4	129.9	79.7	80.1
January 1988	681.4	694.6	9.36	9.62	129.0	130.2	79.3	80.2
February	684.5	698.0	9.46	9.67	128.7	130.6	78.9	80.4
March	687.2	702.6	9.57	9.75	129.2	131.1	79.1	80.6
April	691.4	705.5	9.60	9.83	129.5	131.4	79.2	80.7
May	694.8	708.1	9.65	9.89	129.7	131.7	79.2	80.7
June	697.0	709.6	9.71	9.96	129.6	132.0	79.0	80.8

Fore. = May Forecast
C.E. = Current Expectations
* = This item and those beyond it are expectations

PRICES

	CPI-U (seasonally adjusted)		PPI Finished Goods (seasonally adjusted)		PPI-Industrial Commodities (unadjusted)		Estimated GNP Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	333.6	333.6	291.7	291.7	313.6	313.5	116.0	115.8
February	335.0	335.0	291.9	291.9	315.7	314.9	116.2	116.1
March	336.3	336.4	293.1	293.2	315.8	315.8	116.5	116.5
April	337.5	337.9	294.7	295.3	316.4	317.4	116.9	116.9
May	338.6	339.0	296.0	296.2	316.9	318.6	117.3	117.2
June	339.5	340.4	297.3	296.8	317.1	320.2	117.7	117.6
July	340.9	341.4*	298.5	296.7*	317.9	321.8*	118.0	118.0*
August	342.2	342.5	299.8	297.0	319.2	321.5	118.4	118.4
September	343.5	343.5	300.6	296.9	317.2	319.2	118.8	118.8
October	344.7	345.0	301.5	298.5	319.8	322.7	119.2	119.3
November	345.9	346.1	302.3	299.1	320.5	323.8	119.5	119.7
December	347.2	347.5	303.1	300.2	321.3	325.0	119.9	120.1
January 1988	348.2	348.6	303.8	301.1	322.9	326.2	120.4	120.5
February	349.3	350.0	304.5	302.3	324.5	327.5	121.0	121.0
March	350.4	351.1	305.2	302.9	326.0	328.3	121.6	121.4
April	351.9	352.5	306.0	304.1	325.6	329.9	121.9	121.9
May	353.7	353.9	306.9	305.3	326.5	331.0	122.2	122.3
June	355.5	355.3	307.8	306.5	327.7	331.9	122.6	122.8

	Consumption Deflator		Consumer Durables		Consumer Nondurables		Consumer Services		Implicit Construction Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
January 1987	116.5	116.5	106.0	104.9	109.2	109.3	124.8	125.1	110.6	111.9
February	116.8	116.8	106.4	105.5	109.8	109.6	125.2	125.6	110.9	113.0
March	117.2	117.4	106.4	105.7	110.2	110.5	125.6	126.0	111.1	113.7
April	117.7	117.7	106.7	106.0	110.7	111.1	126.1	126.2	111.4	114.8
May	118.1	118.3	107.1	105.9	111.1	111.8	126.6	126.8	111.7	114.0
June	118.5	118.8*	107.5	106.2*	111.5	112.3*	127.1	127.4*	112.0	114.2*
July	119.0	119.3	107.9	106.4	111.9	112.8	127.5	127.9	112.3	114.3
August	119.5	119.7	108.2	106.7	112.2	113.1	128.0	128.4	112.6	114.6
September	119.9	120.0	108.5	107.1	112.5	113.4	128.6	128.9	112.8	115.0
October	120.4	120.6	108.9	107.4	112.9	113.7	129.2	129.4	113.1	115.2
November	120.8	121.0	109.3	107.7	113.4	114.1	129.7	130.0	113.5	115.5
December	121.2	121.5	109.7	108.0	113.8	114.5	130.2	130.5	113.9	115.7
January 1988	121.7	121.9	110.0	108.3	114.2	114.9	130.7	131.0	114.2	116.0
February	122.2	122.4	110.2	108.7	114.6	115.4	131.2	131.5	114.4	116.2
March	122.6	122.8	110.5	108.9	115.0	115.9	131.8	132.0	114.7	116.5
April	123.1	123.3	110.8	109.1	115.5	116.3	132.4	132.6	115.0	116.9
May	123.6	123.8	111.2	109.4	115.9	116.7	133.0	133.2	115.3	117.2
June	124.0	124.3	111.5	109.7	116.4	117.2	133.6	133.8	115.8	117.5

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